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Searching for an Alternative to Economic Partnership Agreements

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On January 1, 2008, Economic Partnerships Agreements (EPAs), currently being negotiated between the European Union (EU) and nearly 80 African, Caribbean, and Pacific (ACP) countries, are expected to replace the Cotonou Agreement, which has governed trade relations between these countries since 2000. The Cotonou Agreement, implemented through a waiver from the World Trade Organization (WTO), expires on December 31, 2007. At the second EU-Africa summit, held in Lisbon on December 8–9, trade issues have been a major bone of contention, with several African heads of state denouncing the way the negotiation had been led by the European Commission. At the end of the summit, the Commission agreed to continue EPA negotiations in 2008.

The EPAs cover a broad agenda and are supposed to boost ACP economic growth. They encompass a particularly sensitive dimension: trade. Indeed, the transition from the old fashioned Lomé Convention (which preceded the Cotonou Agreement) to the EPAs was driven in large part by trade issues—namely the need to make the EU tariff preferences granted to ACP countries compatible with WTO rules. Compatibility in this case entails quasi-reciprocal free trade between the EU and six groups of ACP countries. But open access to markets remains a highly contentious and unresolved issue in the negotiations. Practically speaking, under the EPAs, the EU would eliminate all remaining barriers on products coming from ACP countries. In reciprocal but asymmetric fashion, all ACP countries would open their borders to European products. The asymmetry would have two dimensions: (1) up to 20 percent of ACP imports from the EU would be exempt from the agreement (sensitive products clause) and (2) ACP countries would have time (up to 20 years) to implement the agreement. Furthermore, to foster regional integration the six ACP negotiating groups would be expected to evolve into free trade areas or custom unions: Southern Africa (SADC), Eastern and Southern Africa (ESA/COMESA), Western Africa (ECOWAS), Central Africa (CEMAC and part of ECCAS), Caribbean (CARIFORUM), and Pacific.[1]

[1] The Southern Africa negotiating group consists of 7 Southern African Development Community (SADC) countries; Eastern and Southern Africa consists of 15 Common Market for Eastern and Southern Africa (COMESA) countries; Western Africa consists of 14 countries in the Economic Community of West African States (ECOWAS) and Mauritania; Central Africa consists of 6 countries in the Economic and Monetary Community of Central Africa (CEMAC) and 2 countries in the Economic Community of Central African States (ECCAS); Caribbean is made up of 15 Caribbean Forum (CARIFORUM) countries and Dominican Republic; and the Pacific group consists of 14 countries of the Pacific region.

While the EPAs are expected to go into effect at the start of 2008, debate is growing about the pertinence of such agreements for both parties. A key question in this debate is whether the EPAs represent an option that would benefit ACP countries. For the European Commission (EC), the EPAs would be the best means of promoting economic growth and modernization in Africa and the most effective replacement for the ineffective EU policies based on the Lomé framework. For many NGOs and African countries, opening vulnerable economies to EU products would cut fiscal resources available to governments and wash away nascent industries. The latter also note that potential export gains for ACP countries appear weak because the EU has very little new to offer, given the current level of preferences that it has already conceded. The only positive aspect is related to the institutional-capacity-strengthening program that would be a part of the aid dimension of the EPAs. Some economists add that the EPA market-access design would have perverse effects on ACP trade policies because it would increase tariff dispersion both across partners (as a consequence of the free trade areas) and across products (as a consequence of the sensitive products clause). Moreover, the agreement would cause collateral damage because trade diversion (switching from non-EU suppliers to EU suppliers) would harm many third countries.

Despite these inherent weaknesses, the European Commission argues that EPAs are the only means of preserving ACP market access to the EU. Otherwise, the less generous Generalized System of Preferences (GSP) would have to replace current preferences. This move would have negative impacts on ACP economies due to more restrictive rules of origin, even for the least-developed countries, which benefit from duty-free and quota-free access thanks to the EU's Everything But Arms (EBA) initiative.[2]

The aim of this brief is not to support or oppose the EPA process, but to assess its consequences for the EU, the ACP countries, and third countries by focusing on the trade component of the agreement. The intent is to open the discussion to a range of approaches. Indeed, for ACP countries the current debate has been quickly reduced to the proverb: choose the lesser of two evils, EPA or GSP. But are there reasonable alternatives to these two options? And are these alternatives compatible with WTO regulations? Would they be worthwhile from an economic point of view?

The Legal Dimension of Negotiations

WTO membership is founded on the Most Favored Nation (MFN) principle, which prohibits WTO members from discriminating among trade partners. While this general principle rules the world trading system, some exceptions are allowed.

The European Union has argued that the only possible alternative to the EPAs that would be compatible with WTO rules is the GSP regime. In reality, however, alternatives are possible.

Article XXIV of the General Agreement on Tariffs and Trade (GATT), which serves as a legal basis for free trade areas, defines the current framework for the EPAs. Under this Article, discrimination in a WTO member's trade policy arising from membership in a free trade area or customs union is allowed, provided that it does not entail rising protection against non-members of the free trade area (Article XXIV; subparagraphs 5a and 5b) and that "duties and other restrictive regulations of commerce (…) are eliminated with respect to substantially all the trade between the constituent territories in products originating in such territories" (Article XXIV, subparagraph 8bi). It is important to note that this provision does not define a clear-cut operational criterion; instead, it leaves that issue open to interpretation.

The EU interpretation of what is WTO-compatible overlooks certain aspects of the Enabling Clause (November 28, 1979) and the WTO law. It is well known that the Enabling Clause authorizes WTO members to grant preferential treatment to all developing countries or least-developed countries. But it should be noted that WTO members can grant specific market access, beyond that provided for under the GSP, to developing countries with particular needs (Appellate Body Report [paragraph 173] on the EC-India Panel on EC-Preferential Tariffs, issued on April 7, 2004). The ruling in question allows for differential treatment through preferential tariff schemes as long as such treatment is available to all "similarly-situated" beneficiaries (that is, countries sharing the same "development, financial, and trade needs"). It could well be argued that the small and vulnerable economies (SVEs) category meets this requirement for differential treatment.

Finally, WTO members currently offer preferential treatment that does not comply with previous WTO clauses

[2] The EBA initiative was implemented in 2001. However, total liberalization for some products was delayed: bananas in 2006, and sugar and rice in 2009.

to a subset of developing countries: this is the case with the African Growth Opportunity Act (AGOA) and the Caribbean Basin Initiative (CBI) granted by the US. Along these lines, as recently proposed by Patrick Messerlin and Claire Delpeuch (of Groupe d'Economie Mondiale (GEM) at Sciences Po),[3] ACP countries could offer multilateral market access to ensure that a new preferential waiver will be granted and that no WTO members will raise a veto against it. Alternatively, and following the article XXIV procedure and the incoming EPA framework, the waiver proposal could be part of the "Interim Agreements." Ultimately, the problem of a waiver is not its legal dimension but its political one.

Contrary to the conventional view that the GSP is the only alternative to the EPA, the brief history recounted above shows that there are other options: the EU could concede that specific access to ACP countries should be extended to all small and vulnerable economies based on the idea that they are a subset of similarly situated developing countries, or the ACP countries could carry out a certain degree of multilateral liberalization in order to benefit the rest of the world. These are the options analyzed below.

Methodology

The analysis is performed with the MIRAGE model of the world economy.[4] MIRAGE is a multi-sector, multi-region, computable general equilibrium model devoted to trade policy analysis.[5] Standard closure is assumed with an underlying optimistic hypothesis concerning the EPA outcome (with no constraint on exchange rate flexibility and perfect price transmission to consumers).[6]

The geographical decomposition focuses on EPA regions, but also on major WTO actors (China, the United States, the Southern Common Market [MERCOSUR] countries, and Central America).

We carry out five scenarios of trade liberalization. For each scenario we compare the outcome in 2018 and 2035 of a baseline scenario and a trade-reform scenario implemented from 2008.

The first scenario corresponds to the EPAs. The "EPA" scenario combines three levels of liberalization: (1) Exports of ACP countries gain immediate, free access to the EU market in 2008. (2) Eighty percent of the EU's exports gain free access to ACP markets according to the specificity of each product. Products are classified into five categories. Sensitive products are excluded from trade liberalization and must represent 20 percent of the trade flows from EU to ACP countries. The four other categories of products that account for the potential impact on ACP imports and loss of tariff revenues are liberalized in varying timeframes, with liberalization completed in 2029. (3) Free trade areas are established within each ACP zone by 2008.

As mentioned earlier, the EU claims that the only alternative to EPAs would be a return to GSP. Hence, we design a "GSP" scenario in which exports from ACP countries to the EU would face GSP duties from 2008 onward.

A third, "SVE," scenario assumes that the EU grants small and vulnerable economies the Cotonou advantages beginning in 2008. The SVEs comprise a de facto WTO category. Since the SVEs that would be concerned about this new trade concession are neither ACP nor least-developed countries, they are few in number.

The last two scenarios include multilateral liberalization by ACP countries in order to benefit exporting countries external to the negotiations. We design two alternatives.

The first one, called "EPAMULTI," combines the EPA scenario with multilateral liberalization in ACP countries based on the Swiss formula with a high coefficient (cuts in tariffs are higher when tariffs are higher, but globally liberalization is limited), as defined by Messerlin and Delpeuch ("EPAs: A Plan 'A+'," 2007). This additional liberalization

3 Patrick A. Messerlin and Claire Delpeuch, "EPAs: A Plan 'A+'," GEM-Sciences Po, Paris, November 2007.

4 The MIRAGE model was developed at the Centre d'Etudes Prospectives et d'Informations Internationales (CEPII) in Paris. Full description of the model is available at the CEPII website (www.cepii.fr).

5 Macroeconomic data for 2001 come from the latest GTAP 6.2 database, whereas the data on tariffs for 2004 come from the detailed MAcMapsHS6-v2 dataset, which includes all regional agreements and preferential schemes prevailing in 2004.

6 Even if they are a topic of first interest for many countries, the current high-level prices in agricultural commodities are not considered in our baseline. However, the baseline reproduces an upward trend in them. Moreover, in our comparative analysis framework, these high prices will have a significant outcome mainly if they lead the ACP countries to cut unilaterally their agricultural tariffs in order to reduce the cost of food for their populations. In this case, trade diversion related to these products will not take place.

Table 1 Export variation (US$ billion) under various scenarios

Region/Country	EPA 2018	EPA 2035	GSP 2018	GSP 2035	SVE 2018	SVE 2035	EPAMULTI 2018	EPAMULTI 2035	MULTIPLUS 2018	MULTIPLUS 2035
Bolivia, Uruguay, and Paraguay	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central America	–0.1	–0.2	0.0	0.0	0.3	0.5	–0.1	–0.2	0.0	0.0
China	0.1	–0.1	–0.1	–0.4	–0.2	–0.3	0.2	0.2	0.8	2.0
European Union (27)	14.7	29.4	–3.7	–6.1	1.4	2.1	14.5	28.9	8.5	15.6
India	–0.1	–0.3	0.0	–0.1	0.0	0.0	0.0	–0.1	0.3	0.8
Japan	–0.4	–0.6	0.1	0.1	0.0	–0.1	–0.3	–0.4	–0.1	0.0
Rest of developed Asia	–1.0	–1.7	0.2	0.2	–0.1	–0.1	–0.8	–1.5	–0.1	0.0
Rest of developing Asia	0.1	0.0	0.0	–0.1	0.4	0.7	0.1	0.2	0.3	0.8
Rest of North America	0.0	–0.1	–0.1	–0.1	0.0	0.0	0.0	–0.1	0.3	0.5
Rest of South America	0.2	0.2	0.0	0.0	0.7	1.1	0.2	0.3	0.4	0.7
Rest of SVE countries	0.1	0.1	0.0	0.0	0.3	0.4	0.0	0.1	0.1	0.2
Thailand	0.0	–0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2
Unites States	–1.0	–1.6	0.1	0.0	–0.1	–0.2	–1.0	–1.6	0.0	0.3
South Africa	0.2	0.4	0.0	0.0	0.0	–0.1	0.2	0.4	0.5	1.2
Southern African Development Community (SADC)	3.5	7.1	0.1	0.1	0.0	0.0	3.5	7.2	3.5	7.2
Part of Eastern and Southern Africa (ESA)	1.6	3.0	–0.4	–0.7	0.0	0.0	1.7	3.4	1.6	2.9
Angola, Seychelles, Congo D.R.	0.3	0.7	–0.1	–0.2	0.0	0.0	0.3	0.7	0.5	1.0
Nigeria	0.3	0.5	0.0	0.0	0.0	0.0	0.3	0.5	0.3	0.4
Senegal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rest of Western, Eastern and Central Africa (WECA)	2.0	4.8	–0.6	–1.0	0.0	–0.1	2.1	5.1	2.5	5.8
Rest of Africa	–0.1	–0.1	0.0	0.1	–0.1	–0.1	–0.1	–0.1	0.0	–0.1
Caribbean and Pacific	3.2	6.0	–3.0	–5.0	0.0	0.0	3.6	7.1	3.3	6.5
Rest of the world	–1.0	–2.4	0.0	0.1	–0.1	–0.1	–0.9	–2.1	–0.5	–1.2

Source: Authors' calculations based on the MIRAGE model.

Note: "Southern African Development Community" includes all SADC countries except Angola and South Africa, which is not negotiating EPAs;
"Part of Eastern and Southern Africa (ESA)" is made of Malawi, Mauritius, Zambia, Zimbabwe, Uganda, and Madagascar;
"Angola" belongs to SADC, "Seychelles" to ESA, and "Congo D.R." to CEMAC;
"Rest of Western, Eastern, and Central Africa" includes all of the remaining countries belonging to ESA and CEMAC;
"Caribbean and Pacific" consists of all countries belonging to CARIFORUM (except Haiti, which is in "Rest of South America," and Belize, which is in "Central America"), and the Pacific groups.

aims at providing gains in market access for non-EPA countries, thus making the scenario acceptable to them.

The second one, called "MULTIPLUS," is a scenario in which ACP countries undertake multilateral liberalization such that, at the end of the process, each ACP country has the same global rate of protection as the one implied by the EPA scenario. Furthermore, ACP countries get full, free access to the EU market. This may not be a realistic option, but it could be the most advantageous option for ACP countries from an economic point of view. In addition, it could lead to a different outcome than the EPA scenario in terms of trade diversion and help us understand the distortions implied in the EPA scenario.

Results

Table 1 shows the impact of these various trade scenarios on exports by each zone/country in 2018 and 2035. As illustrated below, the implementation of EPAs boosts EU exports substantially (an increase of $29.4 billion in 2035), with a smaller impact on ACP exports—the SADC exports, however, are hugely augmented (an increase of $ 7.1 billion in 2035). This trade agreement is of great concern for countries that are not currently negotiating an EPA with the EU. For them, the simulation shows that when EPAs are implemented, their export variations add up to a loss of $3 billion in 2018 and $6.5 billion in 2035. Under the multilateral liberalization (EPAMULTI) scenario, this sum is smaller for the non-EPA zones/countries, and even positive under a "strictly multilateral" ACP liberalization (MULTIPLUS) scenario. In 2035, for example, exports of non-EPA countries decrease by $4.8 billion under the EPAMULTI scenario, but they increase by $5.5 billion under the MULTIPLUS scenario. The EU exports less under the various multilateral scenarios than under the EPA scenario.

The GSP scenario is detrimental to ACP exports, except for Senegal (exports of which are only slightly affected) and SADC. The impact is particularly negative for the Caribbean and Pacific zone, which faces a $3 billion decrease in exports in 2018. For some of these countries (Saint Kitts and Nevis, Fiji, Saint Lucia, and so on) it is clear that over a long period of time the Cotonou regime has led to economic specialization in products with a high preferential margin. A return to the GSP regime would be quite detrimental to their economies.

Since it has been designed to shelter the ACP countries from any drastic change, the SVE scenario is a conservative option with very limited impact on ACP exports. Only SVEs that are not ACP countries benefit from this option—namely Bolivia, Cuba, Ecuador, El Salvador, Guatemala, Honduras, Mongolia, Nicaragua, and Paraguay (see Central America, the Rest of Developing Asia, Rest of South America, and Rest of SVE countries in Table 1).

Table 2 shows the impact of various trade scenarios on real income. The implementation of EPAs has an extremely varied effect on ACP countries. SADC and Part of Eastern and Southern Africa in particular, and to a lesser extent the Caribbean and Pacific, would find it beneficial to conclude an EPA. These zones/countries would gain greatly from the elimination of EU trade barriers on meat and sugar (this study, however, does not consider phytosanitary constraints, which would hinder such exports). As these same countries open their own economies, their imports would also increase, but to a lesser degree than their exports, thus leading to an appreciation of their real exchange rates. Let us note that these countries have a more diversified geographic structure of imports than countries in Western or Central Africa, which mostly import from the EU.

For zones/countries such as Senegal; Nigeria; Rest of Western, Eastern, and Central Africa; and Angola, Seychelles, and Congo D.R. the implementation of an EPA does not lead to a surge in exports because they already benefit from very good access to the European market. Conversely, when these ACPs open their economies to European products they experience a substantial rise in imports. Their real exchange rates depreciate and they incur a significant loss of tariff revenues. In a country like Senegal, for example, imports from Europe of beverage and tobacco products, dairy products, other food products, electronic machinery, and motor vehicles range between 70 and 80 percent of total such imports (for wheat it is more than 86 percent and for sugar more than 95 percent). Liberalization of these imports would thus decrease tariff revenues substantially. Table 3 highlights these huge potential losses of revenue if this set of countries implemented EPAs.

A return to GSP results in a negative income shock (Table 2) for all ACP zones/countries except for SADC, which draws a slightly positive increase in real income because its least-developed-country (LDC) exporters benefit from the rise in tariffs faced by non-LDC countries in the ACP, and for Senegal, which shows no change. Table 2 confirms the idea that an extension of the Cotonou preferences to all SVEs is a conservative scenario, leaving real

Table 2 Real income variation (%) under the various scenarios

Region/Country	EPA		GSP		SVE		EPAMULTI		MULTIPLUS	
	2018	2035	2018	2035	2018	2035	2018	2035	2018	2035
European Union (27)	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Southern African Development Community (SADC)	4.4	5.1	0.1	0.1	0.0	0.0	4.5	5.2	4.4	5.1
Part of Eastern and Southern Africa (ESA)	2.1	2.3	−0.6	−0.6	0.0	0.0	2.2	2.4	2.1	2.3
Angola, Seychelles, Congo D.R.	−0.1	−0.2	−0.1	−0.2	0.0	0.0	0.0	−0.3	0.1	−0.1
Nigeria	−0.1	−0.2	0.0	−0.1	0.0	0.0	−0.1	−0.2	0.2	0.3
Senegal	−0.1	0.0	0.0	0.0	0.0	0.0	−0.1	0.0	0.0	0.1
Rest of Western, Eastern and Central Africa (WECA)	−0.1	−0.1	−0.3	−0.3	0.0	0.0	−0.1	−0.1	0.1	0.2
Caribbean and Pacific	0.5	0.5	−0.8	−0.8	0.0	0.0	0.5	0.5	0.6	0.6

Scenario

Source: Authors' calculations based on the MIRAGE model.

Table 3 Variation of tariff revenues (%)

Region/Country	EPA	GSP	SVE	EPAMULTI	MULTIPLUS
Southern African Development Community (SADC)	1.8	0.3	0.0	0.1	2.6
Part of Eastern and Southern Africa (ESA)	−17.1	−2.2	0.0	−24.0	−10.3
Angola, Seychelles, Congo D.R.	−37.8	−1.1	0.0	−40.4	−47.1
Nigeria	−34.4	−0.2	0.0	−35.2	−35.5
Senegal	−45.2	−0.1	0.0	−45.2	−48.1
Rest of Western, Eastern and Central Africa (WECA)	−39.3	−1.2	−0.1	−40.6	−34.9
Caribbean and Pacific	−13.5	−4.1	0.0	−17.1	−8.5

Scenario

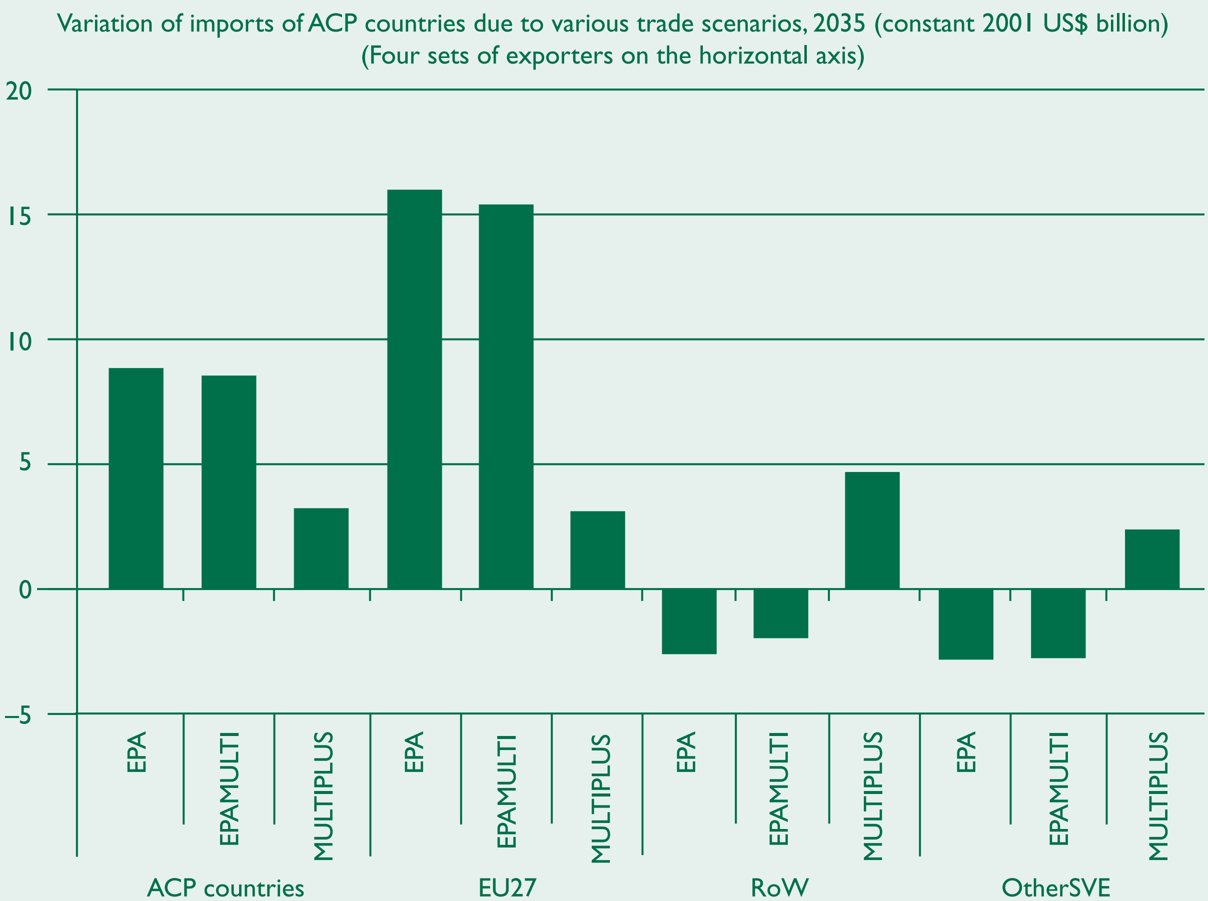
Source: Authors' calculations based on the MIRAGE model.

income unchanged. The introduction of multilateralism, however, is positive for all ACP countries. The EPAMULTI scenario does not change the impact of EPA as much as is expected because the multilateral tariff reduction is limited. Table 3 shows that, compared to the EPA scenario, this kind of multilateral agreement could greatly reduce the loss of tariff revenues for ACP countries.

The MULTIPLUS scenario entails a substantial multilateral tariff cut by ACP countries, which obtain additional market access to other ACP countries. For Nigeria; Senegal; Angola, Seychelles, and Congo D.R.; and Rest of Western, Eastern, and Central Africa the level of market access gained is lower than the level conceded to foreign exporters. Consequently, their imports increase more than their exports and their real exchange rates depreciate. As these economies decrease their rate of protection substantially, their tariff revenue losses increase markedly (see Table 3).

The benefits of multilateral agreements compared to the implementation of an EPA are illustrated in Figure 1, which gives the variation of ACP imports by origin in billions of 2001 constant dollars for 2035. The figure first describes ACP country imports from other ACPs, then from the EU27

Figure 1 Trade diversion effects



Source: Authors' calculations based on the MIRAGE model.

Note: RoW stands for Rest of the World, and Other SVE stands for non-ACP Small and Vulnerable Economies.

countries, the Rest of the World—all countries in the world except ACPs and the EU27—and the SVEs.

It is noteworthy that EPAs enable Europe to increase its exports to ACP countries by $16 billion in 2035 and the ACP countries to increase their exports to each other by $8.8 billion, while exports from SVEs and the Rest of the World to ACP countries decrease by more than $2 billion in each case.

Conversely, the MULTIPLUS agreement, which is strictly multilateral, shows an increase of exports to ACP countries from all zones. The EPAMULTI scenario, an intermediate step (multilateral liberalization with preferential access given to the EU) that limits trade diversion, shows ACP and EU exports to the ACPs increasing.

Figure 1 clearly illustrates that the implementation of an EPA is a huge obstacle to geographic diversification of imports for ACP countries, and that any agreement that includes a dose of multilateralism would favor such diversification.

Conclusions

Although the deadline for completing the EPA negotiations is approaching, there is still much to be said about EPAs, as illustrated by the Lisbon summit. For most of the ACP countries, these agreements could introduce new distortions in their trade policy, such as tariff dispersion across products and across partners, and could substantially reduce tariff revenues and thereby public receipts. In addition, most ACP countries are unlikely to gain substantial access to new foreign markets. In other words, these agreements could divert rather than create trade. This analysis shows that the trade dimension of EPAs is neither the best nor the only choice in response to the expiration of the WTO waiver for the Cotonou preferences.

Furthermore, it shows that there are alternatives to the EPA and GSP, which are currently offered as the only options by the EU. First, new trade preferences can be designed if extended to all non-ACP small and vulnerable economies, a clear pro-development strategy for the EU. Second, a dose of multilateralism can be introduced in order to boost exports from third countries and reduce trade diversion. By now it should be clear that EPAs affect many more countries than those directly involved in the negotiations. Alternatives to the EPA and GSP exist and they should not be overlooked; instead, they need to be and can be scrutinized and discussed as part of the EPA debate. ■

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